# DOW THEORY LETTERS INC.

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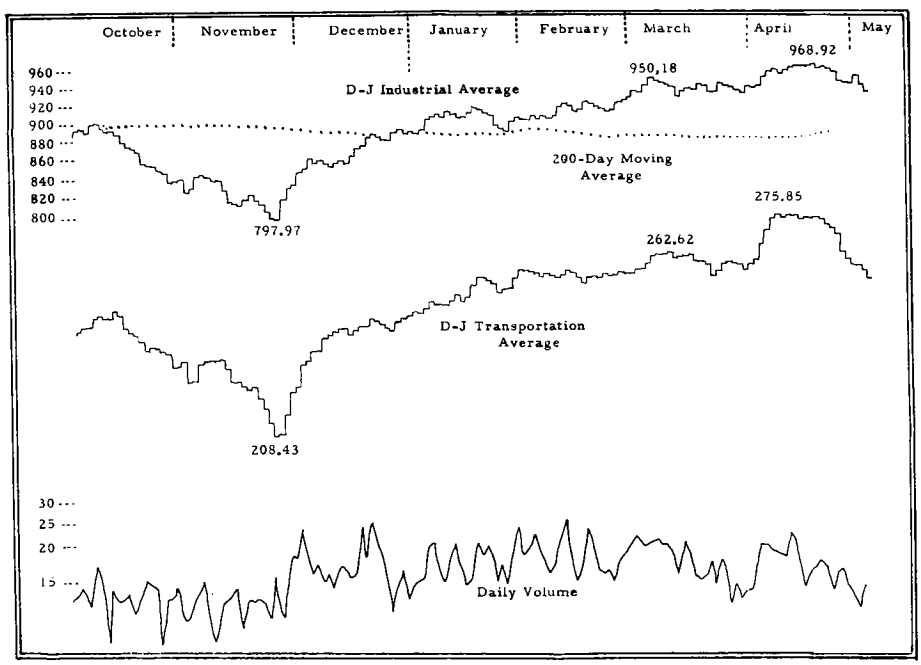
THE PICTURE: I take the collapse of the Muskie campaign as a harbinger of things to come. People are getting increasingly fed up with soft-soap, hucksterism, hypocrisy, outright lies, graft, fraud and what have you. Muskie was too middle-of-the-road. He wouldn't cause a ripple on a lake in mid-summer.

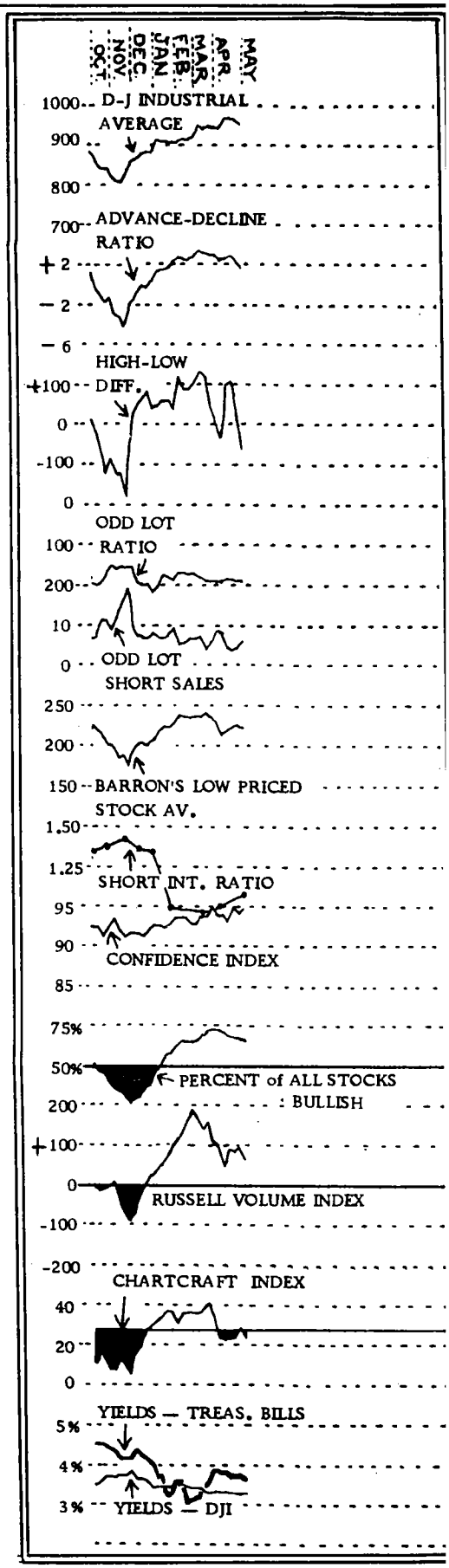
To me, Wallace represents a certain kind of protest vote. McGovern represents another. I am not going into what I think are the possible merits or demerits of these two gentlemen, but I think that they have caught some of the mood of America's frustration.

The frustration goes into every crook and crevice of the nation's activities, from Vietnam to the schools, to the obsession with violence to the racial problems. And it certainly goes into the monetary and financial scene, where it centers on inflation, unemployment, the decline of the dollar and the whole monetary mess itself.

Europe is seeking to protect itself, and it is moving rapidly in that direction. The narrowing of the European currency bands, originally scheduled for June 30, has already occurred (on April 24). The new members of the Common Market, which were to narrow their currency bands at the end of 1972, have moved the date up to June 30. The European nations will meet this Fall for the big monetary conference, and it is there that informed observers believe the price of gold may be increased by a "multiple" of the current price. From what I read, Russia may well play a part in the new European economic and financial union.

The US pursues its "head-in-the-sand" policy of "benign neglect." Alden Wells calls it neglect, not through any benign intention of the US, but "neglect through ignorance." Meanwhile, benign neglect has helped produce the worst trade deficit in our history, and I document that story in the page 2 news clip (for subscribers who haven't got the heart to read today's papers).



The fact is that the rest of the world has ceased following the US, even though the world has played "follow the leader" for a quarter of a century. With over $26 billion in gold now owned by Europe as against less than $10 billion (all of which is mortgaged) residing in the US, only indulgence and the fear of upsetting the applecart keeps Europe from raising a mailed fist in the international financial community.

This past month, the grand old man of French finance, Jacques Rueff, has come out with his new book, "The Monetary Sins of the West." Much of what he has previously written and predicted appears here plus his ideas for sanity in the future. I was pleasantly surprised to see this book favorably reviewed in the pages of the anti-gold New York Times, but then reviewers are allowed to speak their own minds in many responsible publications.

What of the stock market itself, the remorseless barometer of "what lies ahead"? In the last report I wrote (rather skeptically) that "If the Dow is to sweep over the 1000 mark, nobody can say that Wall Street is not prepared for it." I then listed some of the "preparations" including heavy margin debt, huge volume, great speculation and a rabid buying of stocks by insurance companies and pension plans.

However, the "best laid plans" are often no different on Wall Street than anywhere else. On April 13 (as noted in the last Letter) the D-J Utility Average broke to a new low for the year, a strange occurrence for the Average which has been a bellwether for the market for decades.

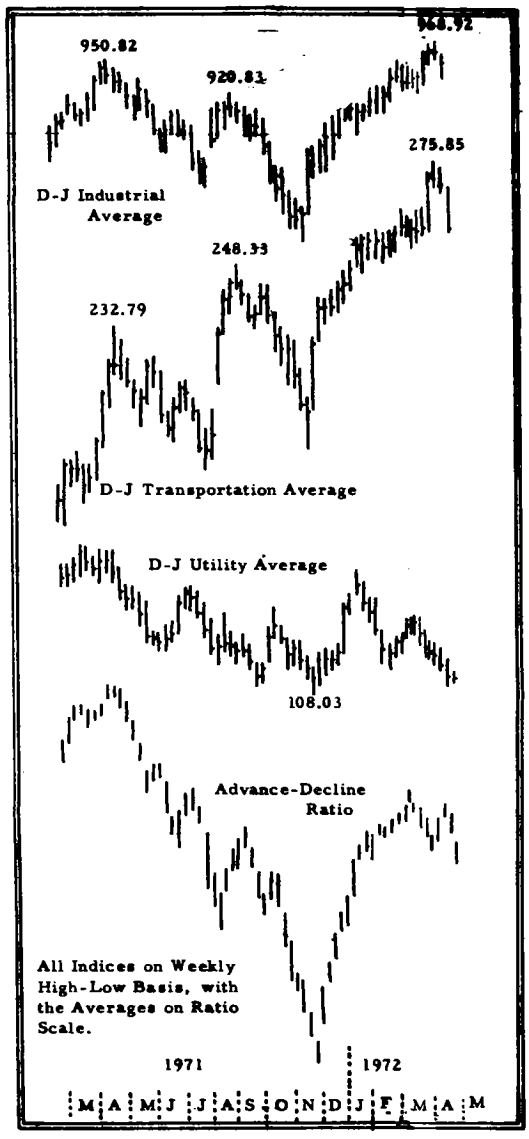
As it happened, the Transports recorded their high for 1972 on April 12 at 275.85. Four trading days later, on April 18, Industrials established their 1972 peak at 968.92 (see page 1 chart). From that point on, the technical deterioration which I have been writing about accelerated, and on April 25 Industrials dropped over 10 points with an almost 6 point drop in transports.

What particularly interested me was the violent decline in the Transportation Average, an Average which I have always felt measures the speculative intensity of the market (since many of the Transports possess heavily leveraged debt structures and since changes in their fortunes can cause wild swings in their earnings). At any rate, it was interesting to note that a downside gap of 10¢ opened on April 25 in the Transports, as the daily high for April 25 was actually 10¢ below the daily low for the preceding day. These gaps in the Averages (see Wall Street Journal chart) are very ra and are usually associated with violence in the direction of the movement which produces the gap. For this reason, I would say that there is probably great technical weakness in the Transportation Average, and it would not surprise me to see Transports following the lead of Utilities in taking the whole market to lower levels.

The last Letter drew particular attention to the ominous performance of the advance-decline ratio during 1972, the page 3 (daily) chart shows the further det ri- tion in the A-D ratio (which has occurred since Letter 527). Last week saw the A-D ratio break below its mid-January bottom (horizontal dotted line on chart), a performance which throws the relationship between the A-D ratio and the Dow completely out of gear. On May 2 and 3 the market broke badly again, and this time the A-D ratio fell to its lowest level since the first day of January. All of the upside work of 1972 had been wiped out.

# Trade Deficit Off To Worst Start On Record

WASHINGTON (AP) — The U.S. trade deficit deepened in March to a three-month record of $1.5 billion, handing the nation its worst yearly start ever in world commerce, the government said yesterday.




The diverging paths taken by the two indicators is traced by the trendlines marked A and B, trendlines which connect the rising peaks in the Dow Industrial Average and the declining peaks in the A-D ratio. I would say that the only way the price-breadth picture could appear worse from a technical standpoint would be a third recovery high in the Dow (above 968.92), with the A-D ratio unable to better its most recent or April peak. I doubt, however, whether this market has the strength to push the Dow above the 968.92 point. As of this writing, the ingredients are certainly present for a major decline (dare I say collapse?).

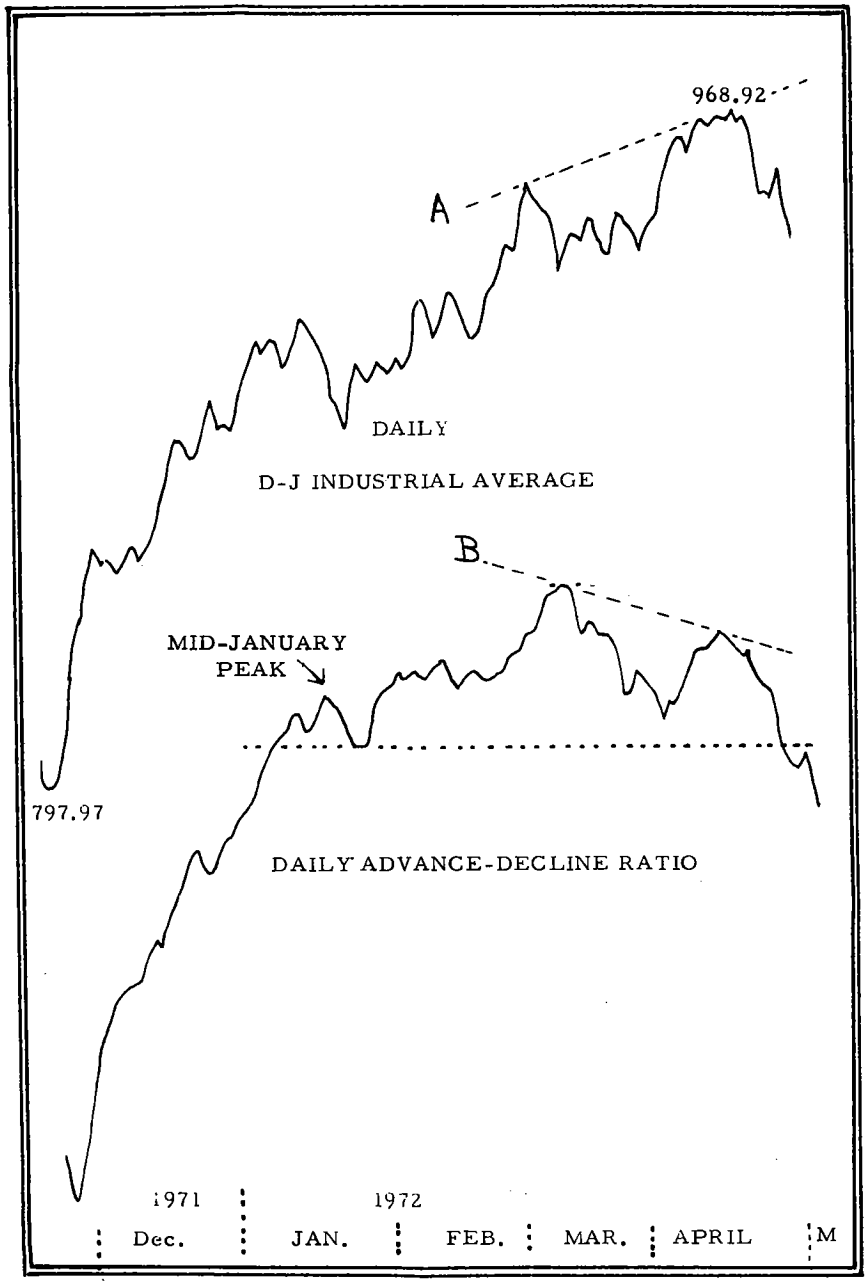
* * * *

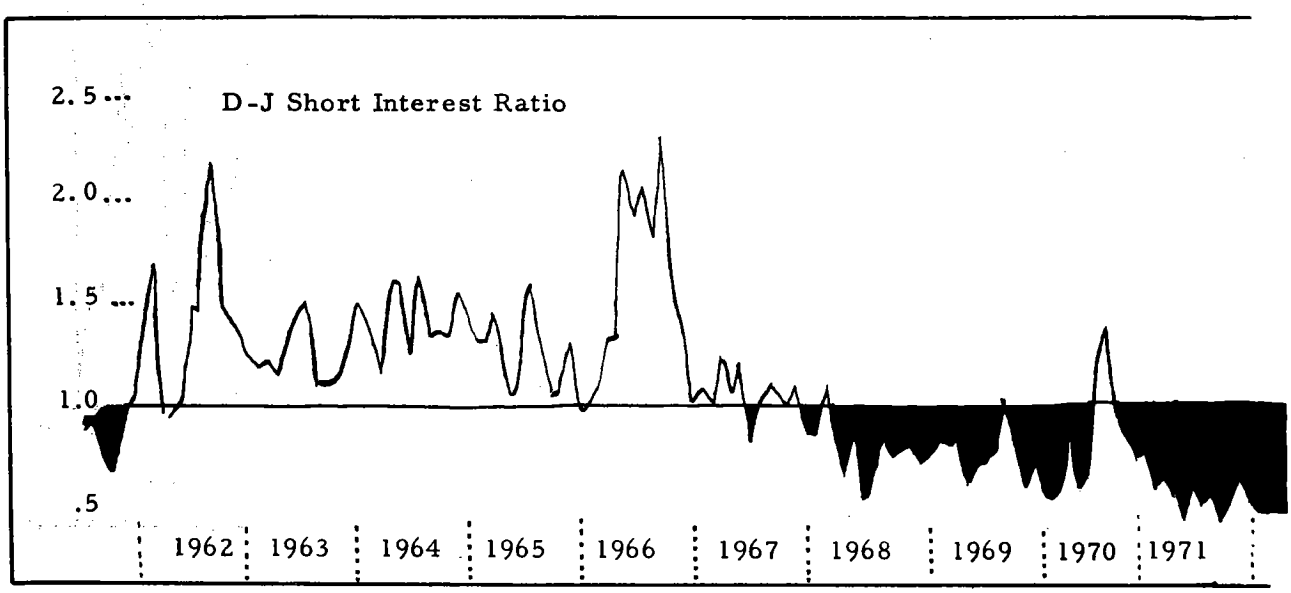
The new technical craze concerns member shorting on the Big Board, and several excellent services deal with this in a most professional manner. Member shorting (supposedly informed) has been running high for many weeks now, while odd-lot shorting (notoriously uninformed) has been running at outstandingly low levels (see page 1 chart). Martin Zweig presents an excellent article regarding this picture in the May 1 issue of Barron's. All in all, the short picture provides a very bearish outlook for the market now, but I hope that too much publicity doesn't "kill" this indicator over the foreseeable future.

DOW SHORT INTEREST RATIO: At the bottom of this page I include the DSIR updated from Letter 525, and showing the mid-March to mid-April figure. This figure, just computed and sent to me by Bill Gordon of New York (who originated this ratio) was a very low .44. This makes the figures for the first four months of 1972 .44, .43, .45 and .44, the lowest series of four figures in the history of the DSIR going back to 1931.

Considering that a 1.0 is considered neutral on the DSIR, given the current trading volume we would need about twice the current 580 thousand shorts in the 30 Dow Industrials to bring the DSIR to neutral! So in view of today's volume and Dow short position, the DSIR is saying that the market is in a highly dangerous position. There is far too little pessimism (i.e., shorting) in the 30 Dow giant stocks, and the technical position of the Industrial Average is extremely precarious.

COMPARISONS: In the last report I included my chart of the weekly new highs and new lows. In studying the chart and statistics, I was struck at the greater apparent weakness in the current figures compared with the figures following the April top of 1971.



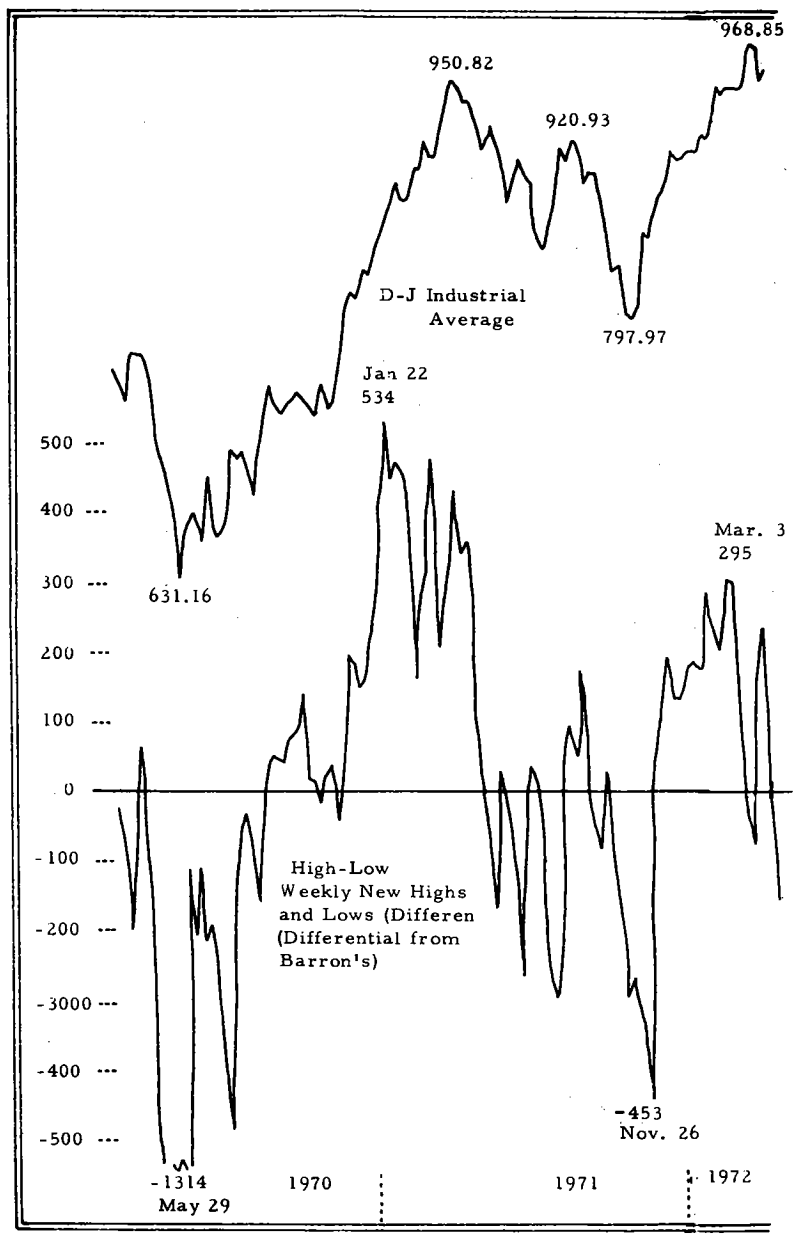
For instance, I noted in the last Letter (and see chart) that at the peak of high-low strength in 1971 the index (which is the differential in the number of weekly new highs and new lows) hit 534 in 1971. In contrast, the peak of high-low strength in 1972 (with the Dow Industrials 18 points higher) was only 295. This shows a great deal less strength in 1972 compared with 1971.

From another standpoint, I find the comparisons interesting:

| | | Dow Price | High-low index | |
|---|---|---|---|---|
| April 28 | Dow peak | 950.82 | 357 | |
| May 7 | | 937 | 123 | 1971 |
| May 14 | | 936 | 20 | |
| May 21 | | 922 | -96 | |
| | | | | |
| April 18 | Dow peak | 968.92 | 10 | |
| May 1 | | 954.17 | -163 | 1972 |

Note that in 1971, on the week which produced the Dow Industrial peak of 950.82, the high-low index stood at a rather high 357. But in 1972, on the week of the 968.92 recovery high, the high-low index was only 10.

From another standpoint, the comparisons are most interesting. It took three weeks following the 1971 Dow peak before the high-low index dropped into negative territory. But this year (see tabulation), the high-low index plunged into minus territory the very week after the Dow recovery high. This, it seems to me, is an outstanding show of technical weakness.




MOST ACTIVES: In this Letter I am trying to document some of the technical deterioration which has actually been taking place ever since the last quarter of 1971. One of the places where we can see this deterioration is in the index of the "most active" stocks (page 5).

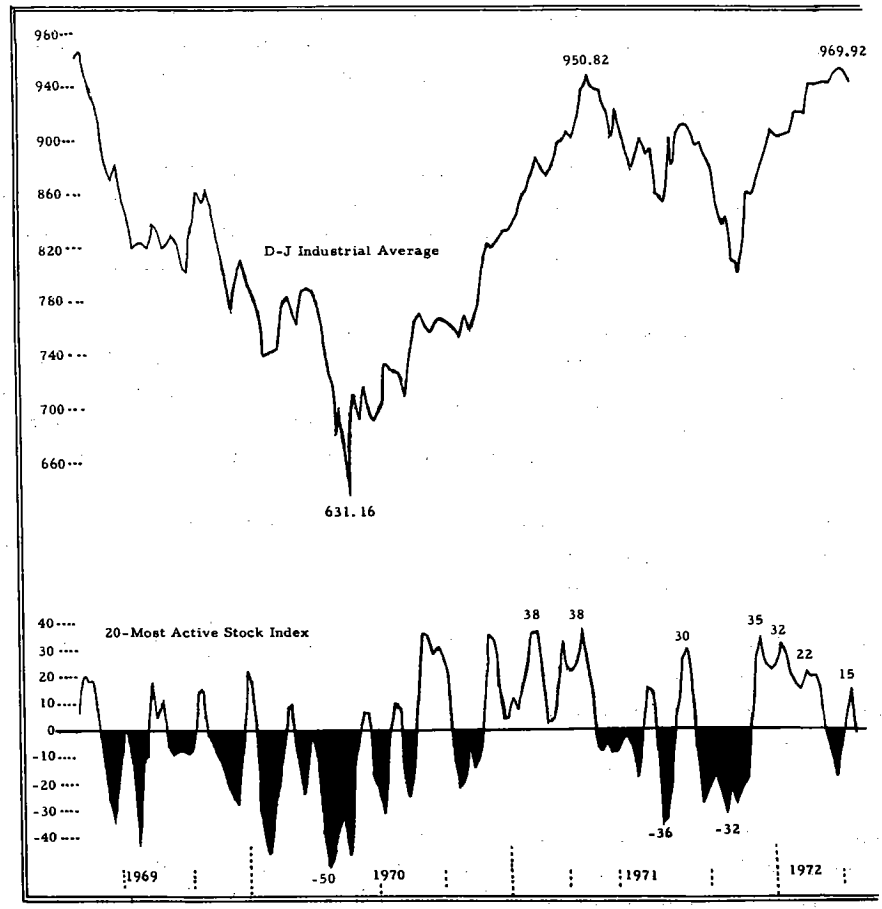
Each week Barron's and many newspapers (Sunday financial section) publish a listing of the 20 most active stocks for that week. As a general rule, volume in these 20 stocks makes up about 15% of all the volume on the NYSE for the week. But more importantly, the direction of the most active stocks has a tendency to lead the direction of the rest of the market.

**The index shown here is simple enough. It is a three-week moving average of the plurality of pluses or minuses in the most active stocks. For instance, on a given week 15 of the most-actives advance and 5 decline. The figure for the week (the plurality) would be plus 10. If the previous two weeks showed a plus 5 and a plus 2, the entry on the chart would be a plus 17 (or the total for the most recent three weeks.**

The most-active index proved quite valuable during early 1971. There (see chart) we had a peak index reading of 38, one on February 12 and one on April 16. The Dow Industrials recorded their 1971 peak on April 28 at 950.82. But on that week the index had dropped to plus 13, less than half the previous peak reading. This preceded the Dow Industrial slide to the November low of 797.97.

This year the technical deterioration is much more obvious and more insistent. In December we had an index reading peak of 35. A decline followed, and then a new index reading of 32 on January 14. Another decline in the index, and an index reading of 22 appeared on February 18. The index dropped into negative territory on March 17, and a rally took it back to 15 on the week ending April 23. And that was the week which saw a recovery high of 968.92 on the Dow.

Then last week (week ending April 29) saw the index drop back to minus 1. All in all, I would have to call this a most negative performance on the part of the most-active index.



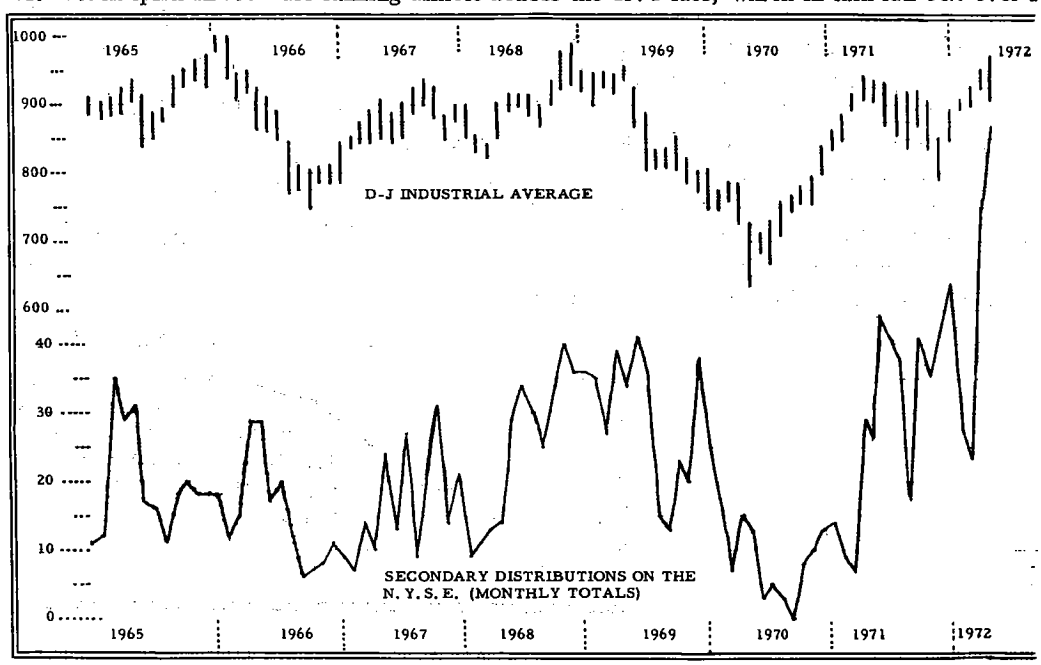

DISTRIBUTION: In Letter 525 I showed the chart of secondary distributions, and I noted that the month of March saw a new record of 59 secondary distributions. This was far above the number of secondaries which appeared either in early 1966 or during 1968-69.

The April, 1972, figures are now in (see chart), and I was amazed to see that April produced 72 secondaries, following the record March figure. If anyone can question the fact that distribution is going on in this market, let him study this chart.

In Letter 525 I also included the yearly volume chart, which indicated that although the Dow Industrials made their all-time high of 995.15 in 1966, NYSE volume has continued to rise until it hit new record peaks last year. With all this volume, I feel it is most significant that the Dow has been unable to push above its 1966 high. The inference is that it is taking more and more volume to produce less and less upside action on Wall Street. The final result should be "exhaustion," and there is a good chance we are about there now.

In Letter 526 I presented another indicator of Wall Street distribution, and that is the number of stock splits. Here again the indicator is going through the roof. Stock splits in 1972 are running almost double the 1971 rate, which in turn ran 66% over 1970. Thus, investors are using every trick and device to move stocks into the hands of the public.

In view of this, it is most interesting to note that the mutual funds are receiving huge numbers of redemptions, and during the month of March the amount of redemptions over sales struck a record of $193.7 million. This would hardly suggest that the public is gobbling up stocks via the mutual fund route.



"Who is buying the stocks?" we ask. The answer is the pension funds, the insurance companies, and the institutions. In this month's Forbes there is an interesting article on the Bethlehem Steel pension fund, which now is 75% in stocks. One of the reasons for the incredible boost in the equity percentage is the desire on the part of company management to boost fund assets in the market and so attempt to take some of the strain off the company which must contribute towards the funds and towards social security as well.

Personally, I feel that the whole pension fund picture is becoming highly dangerous, and the funds are literally depending on good action in common stocks to ward off any possible disaster. I can't imagine what will happen when this market turns down with a vengeance and the pension funds earmarked for corporation workers, states, city and federal employees, workers in every walk of life are in jeopardy. It will simply add up to one of the biggest financial messes in US history.

CALL ME A NUT! I read dozens of other advisory services each week, and for some absurd reason I am constantly bothered by incorrect punctuation (this is hardly a suggestion that mine is perfect). My number one complaint is improper splitting of words with a hyphen. NOTE, a one syllable word cannot be split. And although words of two syllables or more can be split, they may only be split at the syllable, and a good dictionary should be consulted in order to determine the point of split. Actually, there are certain publications which specialize in identifying word splits, and my typists find these extremely handy.

My second complaint is the split infinitive (I guess I'm a fuddy-duddy). For instance, to go is an infinitive. To quickly go is a split infinitive. The phrase should read, to go quickly or quickly to go. But nothing should appear between the words to and go. That is splitting the infinitive.

Now, to my amazement and edification, Market Indicators Digest (published by Fred Macaskill out of Johannesburg, South Africa) has come up with some information on abbreviations. Fred correctly states that the following abbreviations are correct: Mr for mister, St for saint, Dr for doctor. But so are these correct: Maj. for major, Pres. for president. Why the period after some abbreviations and not others, we ask? Because of this rule; when the abbreviation ends with the same letter as the abbreviated word, the period is not used. When it ends with a different letter (such as in president), the period is used.

Second rule: When an abbreviation combines the first capital letter of two or more different words, the period is omitted. Examples are USA, UK, SA, CIA. Well, I guess I'm going to get dozens of angry letters saying what a lousy writer I am and how people read me despite my pathetic punctuation. I plead guilty in advance!

GOLD, SILVER: On Monday, May 1, gold added another chapter to history by climbing over the $50 per ounce level. This is shown on the weekly chart at right. Personally, I wonder if gold is not moving towards a reflection of a European gold-price boost in the Fall, a boost which could be a "multiple" of the current absurd $38 US price. At any rate, the insistence of the climb in the bullion price is almost breath-taking, and the modest price of gold shares is evidence of the public skepticism regarding the reality of gold. Ultimately (and it may not take long), I feel that the professionals and public could enter the gold picture with "both feet." If and when that happens, it will be too late to buy the golds as they will move up and no doubt make up for lost time.